

The Companies of Doral Financial Corporation

Puerto Rico

Doral Mortgage Corporation

Doral Financial Plaza
1451 FD Roosevelt Avenue
San Juan, Puerto Rico 00920-2717

HF Mortgage Bankers

279 Ponce de León Avenue, 6th floor
Hato Rey, Puerto Rico 00918-2003

Centro Hipotecario De Puerto Rico, Inc.

305 FD Roosevelt Avenue
Hato Rey, Puerto Rico 00918-4149

Sana Mortgage Corporation

Urb. Caribe
1569 Alda Street
Doral Bank Building, Suite 302
Rio Piedras, Puerto Rico 00926-2712

Doral Bank-Puerto Rico

Doral Bank Plaza
33 Resolution Street
San Juan, Puerto Rico 00920

Doral Securities, Inc.

Doral Financial Plaza
1451 FD Roosevelt Avenue
San Juan, Puerto Rico 00920-2717

Doral Insurance Agency, Inc.

Doral Financial Plaza
1451 FD Roosevelt Avenue
San Juan, Puerto Rico 00920-2717

Doral Properties, Inc.

Doral Financial Plaza
1451 FD Roosevelt Avenue
San Juan, Puerto Rico 00920-2717

Doral International, Inc.

Doral Financial Plaza
1451 FD Roosevelt Avenue
San Juan, Puerto Rico 00920-2717

New York

Doral Bank, FSB

387 Park Avenue South
New York, New York 10016-8810

Doral Money, Inc.

387 Park Avenue South
New York, New York 10016-8810

Locations

Doral Mortgage Corporation

Arecibo (2 locations)
Bayamón (3 locations)
Caguas (2 locations)
Carolina (3 locations)
Cayey
Fajardo (2 locations)
Guayama
Guaynabo
Hato Rey (3 locations)
Humacao (2 locations)
Mayagüez (2 locations)
Ponce (2 locations)
Rio Grande
Rio Piedras
San Juan (2 locations)
Toa Baja
Trujillo Alto
Vega Baja

HF Mortgage Bankers

Bayamón
Caguas
Carolina
Catano
Guaynabo (2 locations)
Hato Rey (2 locations)
Mayagüez
Ponce
Puerto Nuevo
Rio Piedras
San Juan (2 locations)
Vega Alta

Centro Hipotecario De Puerto Rico, Inc.

Hato Rey (2 locations)
Manati

Sana Mortgage Corporation

Bayamón (2 locations)
Caguas
Carolina
Las Piedras
Mayagüez
Ponce
Rio Piedras (2 locations)

Doral Bank-Puerto Rico

Arecibo
Bayamón (4 locations)
Caguas (3 locations)
Carolina (3 locations)
Catano (2 locations)
Cayey
Fajardo
Guaynabo (2 locations)
Hato Rey (4 locations)
Humacao (2 locations)
Las Piedras
Manati
Mayagüez (2 locations)
Ponce (2 locations)
Puerto Nuevo
Rio Grande
Rio Piedras (3 locations)
San Juan (2 locations)
Toa Baja
Trujillo Alto
Vega Alta
Vega Baja

Doral Securities, Inc.

San Juan

Doral Insurance Agency, Inc.

San Juan

Doral Properties, Inc.

San Juan

Doral International, Inc.

San Juan

Doral Bank-New York

Park Avenue South,
Manhattan
Washington Heights,
Manhattan
Astoria, Queens
Rego Park, Queens
Bensonhurst, Brooklyn
Flushing, Queens

Doral Money, Inc.

New York, New York

Forward-Looking Statements

The information included herein may contain certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and involve certain risks and uncertainties that may cause actual results to differ materially from those expressed in forward-looking statements. Factors such as changes in interest rate environment as well as general changes in business and economic conditions, competition, fiscal and monetary policies and legislation may cause actual results to differ from those contemplated by such forward-looking statements. For a discussion of such risks and uncertainties, see the Corporation's Form 10-K for the year ended December 31, 2004 filed with the U.S. Securities and Exchange Commission. The Corporation assumes no obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Stock Prices and Dividend Policy**Market for Doral Financial's Common Equity and Related Stockholder Matters**

Doral Financial's Common Stock, \$1.00 par value (the "Common Stock"), is traded and quoted on the New York Stock Exchange ("NYSE") under the symbol "DRL." From December 19, 1988, to January 7, 2003, Doral Financial's Common Stock was traded on the National Association of

Securities Dealers Automated Quotation National Market System (the "NASDAQ National Market") under the symbol "DORL."

The table below sets forth, for the calendar quarters indicated, the high and low closing sales prices and the cash dividends declared on the Common Stock during such periods.

Year	Calendar Quarter	Price Range		Dividends Per Share
		High	Low	
2004	4th	\$ 49.250	\$ 39.790	\$ 0.180
	3rd	42.880	34.480	0.150
	2nd	35.630	30.880	0.150
	1st	35.420	29.870	0.120
2003	4th	\$ 34.673	\$ 31.367	\$ 0.120
	3rd	33.267	26.660	0.093
	2nd	31.140	23.567	0.093
	1st	23.667	18.733	0.093

As of January 27, 2005, the approximate number of record holders of Doral Financial's Common Stock was 482, which does not include beneficial owners whose shares are held in record names of brokers and nominees. The last sales price for the Common Stock as quoted on the NYSE on such date was \$42.77 per share.

Doral Financial has three outstanding series of nonconvertible preferred stock: 7.25% noncumulative monthly income preferred stock, Series C (liquidation preference \$25 per share); 8.35% noncumulative monthly income preferred stock, Series B (liquidation preference \$25 per share); and 7% noncumulative monthly income preferred stock, Series A (liquidation preference \$50 per share), which trade on the NASDAQ National Market. During 2003, Doral Financial issued 1,380,000 shares of its 4.75% perpetual cumulative convertible preferred stock ("the convertible preferred stock") having a liquidation preference of \$250 per share in a private offering to qualified institutional buyers pursuant to Rule 144A. Each share of the convertible preferred stock is currently convertible into 6.2856 shares of common stock, subject to adjustment under specific conditions. The convertible preferred stock ranks on parity with Doral Financial's other outstanding preferred stock with respect to dividend rights and rights upon liquidation, winding up or dissolution.

The terms of Doral Financial's preferred stock do not permit Doral Financial to declare, set apart or pay any dividends or make any other distribution of assets, or redeem, purchase, set apart or otherwise acquire shares of the Doral Financial's common stock, or any other class of Doral Financial's stock

ranking junior to the preferred stock, unless all accrued and unpaid dividends on the preferred stock and any parity stock, at the time those dividends are payable, have been paid and the full dividend on the preferred stock for the current dividend period is contemporaneously declared and paid or set aside for payment. The terms of the preferred stock provide that if Doral Financial is unable to pay in full dividends on the preferred stock and other shares of stock of equal rank as to the payment of dividends, all dividends declared upon the preferred stock and such other shares of stock be declared pro rata.

Doral Financial's ability to pay dividends in the future is limited by restrictive covenants contained in its debt agreements, its earnings, cash resources and capital needs, general business conditions and other factors deemed relevant by Doral Financial's Board of Directors. Doral Financial is prohibited under the Indenture for its 7.84% Senior Notes due on 2006 (the "Senior Note Indenture") from paying dividends on any capital stock if an event of default exists under such agreement, or if the amount of dividends payable by Doral Financial together with the aggregate amount of dividends paid and other capital distributions made since October 1, 1996, exceed the sum of: (i) 50% of its Consolidated Net Income (as defined in the Senior Note Indenture), accrued from October 1, 1996, to the end of the quarter ending not less than 45 days prior to the dividend payment date; (ii) \$15 million; and (iii) the net proceeds of any sale of capital stock subsequent to October 15, 1996. As of December 31, 2004, Doral Financial could have paid up to \$1.2 billion in cash dividends under this restriction. Doral Financial is prohibited

under a debt agreement with another financial institution from paying dividends (unless payable in capital stock) on any capital stock if an event of default exists under such agreement or if the amount of dividends paid exceeds the sum of: (i) 50% of its Consolidated Net Income for the fiscal year preceding the fiscal year of the dividend payment, plus (ii) the net proceeds from the sale of its common and preferred stock during the current fiscal quarter and during the immediately preceding four fiscal quarters. As of December 31, 2004, Doral Financial could have paid up to \$146.8 million in cash dividends under this agreement. In addition, under other debt agreements, Doral Financial may be prohibited from paying dividends if it is in default under such agreements.

Doral Financial's ability to pay dividends may also be restricted by various regulatory requirements and policies of bank regulatory agencies having jurisdiction over Doral Financial and its subsidiaries.

The Puerto Rico Internal Revenue Code generally imposes a 10% withholding tax on the amount of any dividends paid by Doral Financial to individuals, whether residents of Puerto Rico or not, trusts, estates, special partnerships and non-resident foreign corporations and partnerships. Prior to the first dividend distribution for the taxable year, individuals who are

residents of Puerto Rico may elect to be taxed on the dividends at the regular graduated rates, in which case the special 10% tax will not be withheld from such year's distributions.

United States citizens who are not residents of Puerto Rico may also make such an election except that notwithstanding the making of such election, a 10% withholding will still be made on the amount of any dividend distribution unless the individual files with Doral Financial's transfer agent, prior to the first distribution date for the taxable year, a certificate to the effect that said individual's gross income from sources within Puerto Rico during the taxable year does not exceed \$1,300 if single, or \$3,000 if married, in which case dividend distributions will not be subject to Puerto Rico income taxes.

United States income tax law permits a credit against United States income tax liability, subject to certain limitations, for Puerto Rico income taxes paid or deemed paid with respect to such dividends.

The following table sets forth certain selected consolidated financial data for Doral Financial for each of the five years in the period ended December 31, 2004. This information should be read in conjunction with Doral Financial's Consolidated Financial Statements and related notes thereto.

Selected Financial Data

(Dollars in thousands, except for share data)	Year ended December 31,				
	2004	2003	2002	2001	2000
Selected Income Statement Data:					
Interest income	\$ 570,847	\$ 452,570	\$ 415,600	\$ 356,095	\$ 325,545
Interest expense	304,949	271,090	263,178	271,668	283,241
Net interest income	265,898	181,480	152,422	84,427	42,304
Provision for loan losses	5,507	14,085	7,429	4,445	4,078
Net interest income after provision for loan losses	260,391	167,395	144,993	79,982	38,226
Non-interest income	450,384	411,772	255,393	191,132	150,317
Non-interest expenses	209,052	185,802	139,410	112,854	92,391
Income before income taxes and cumulative effect of change in accounting principle	501,723	393,365	260,976	158,260	96,152
Income taxes	12,098	72,066	40,008	20,338	11,496
Income before cumulative effect of change in accounting principle	489,625	321,299	220,968	137,922	84,656
Cumulative effect of change in accounting principle, net of tax	—	—	—	5,929	—
Net income	<u>\$ 489,625</u>	<u>\$ 321,299</u>	<u>\$ 220,968</u>	<u>\$ 143,851</u>	<u>\$ 84,656</u>
Cash Dividends Declared:					
Common stock	<u>\$ 64,744</u>	<u>\$ 43,218</u>	<u>\$ 30,185</u>	<u>\$ 21,543</u>	<u>\$ 15,943</u>
Preferred stock	<u>\$ 33,299</u>	<u>\$ 21,088</u>	<u>\$ 13,730</u>	<u>\$ 9,408</u>	<u>\$ 6,806</u>
Per Common Share Data:					
Basic:					
Income before cumulative effect of change in accounting principle	\$ 4.23	\$ 2.78	\$ 1.92	\$ 1.27	\$ 0.83
Cumulative effect of change in accounting principle	—	—	—	0.06	—
Net income	<u>\$ 4.23</u>	<u>\$ 2.78</u>	<u>\$ 1.92</u>	<u>\$ 1.33</u>	<u>\$ 0.83</u>
Diluted:⁽¹⁾					
Income before cumulative effect of change in accounting principle	\$ 3.95	\$ 2.70	\$ 1.89	\$ 1.25	\$ 0.82
Cumulative effect of change in accounting principle	—	—	—	0.06	—
Net income	<u>\$ 3.95</u>	<u>\$ 2.70</u>	<u>\$ 1.89</u>	<u>\$ 1.31</u>	<u>\$ 0.82</u>
Dividends per common share	\$ 0.60	\$ 0.40	\$ 0.28	\$ 0.21	\$ 0.17
Book value per common share	\$ 12.97	\$ 9.45	\$ 7.58	\$ 5.93	\$ 3.99
Weighted-Average Common Shares Outstanding:					
Basic	107,907,699	107,861,415	107,697,114	100,786,932	94,247,343
Diluted ⁽¹⁾	119,744,176	112,661,848	109,438,695	102,381,614	94,710,396
Common shares outstanding at end of period	107,908,862	107,903,912	107,774,022	107,573,252	95,384,552

(Continues)

Selected Financial Data (Continued)

(Dollars in thousands, except for share data)	Year Ended December 31,				
	2004	2003	2002	2001	2000
Selected Balance Sheet Data:					
Cash and cash equivalents	\$ 2,535,726	\$ 954,722	\$ 1,573,291	\$ 594,385	\$ 428,319
Securities held for trading	1,243,543	944,150	1,196,179	993,328	1,101,938
Securities available for sale	4,982,508	2,850,598	862,090	928,179	182,374
Securities held to maturity	2,316,780	1,640,909	960,626	866,335	1,558,313
Total loans ⁽²⁾	3,313,439	3,377,457	3,205,741	2,591,607	1,752,796
Servicing assets, net	203,245	167,498	159,881	154,340	139,795
Total assets	15,102,401	10,393,996	8,421,689	6,694,283	5,463,386
Deposit accounts	3,643,080	2,971,272	2,217,211	1,669,909	1,303,525
Securities sold under agreements to repurchase	6,305,163	3,602,942	2,733,339	2,573,772	2,275,855
Advances from the Federal Home Loan Bank of NY (FHLB)	1,294,500	1,206,500	1,311,500	687,500	389,000
Loans payable	279,560	178,334	211,002	161,101	372,620
Notes payable	1,105,202	602,581	621,303	459,543	444,746
Total liabilities	13,129,632	8,801,556	7,376,718	5,932,163	4,957,676
Stockholders' equity	1,972,769	1,592,440	1,044,971	762,120	505,710
Operating Data:					
Loan production	\$ 7,803,000	\$ 6,479,000	\$ 5,169,000	\$ 4,209,000	\$ 3,174,000
Loan servicing portfolio ⁽³⁾	14,264,000	12,690,000	11,242,000	10,006,000	8,805,000
Selected Financial Ratios:⁽⁴⁾⁽⁵⁾					
Return on average assets	3.85%	3.46%	2.97%	2.33%	1.66%
Return on average common equity	38.54%	32.36%	29.08%	27.13%	23.03%
Dividend payout ratio for common stock	15.19%	14.81%	14.79%	16.10%	20.50%
Average equity to average assets	13.80%	13.39%	12.08%	10.04%	8.49%

(1) Adjusted to reflect the addition of 8.674 million shares of common stock to the fully diluted common stock share base by assuming the conversion of the 1.38 million outstanding shares of the Company's contingently convertible preferred stock according to the provisions of a new accounting pronouncement issued during 2004 by the Emerging Issues Task Force ("EITF"), Issue 04-8.

(2) Includes loans held for sale.

(3) Includes \$1.9 billion, \$2.5 billion, \$1.9 billion, \$1.4 billion and \$867 million of loans owned by Doral Financial at December 31, 2004, 2003, 2002, 2001 and 2000, respectively, which represented 14%, 20%, 17%, 14% and 10%, respectively, of the total servicing portfolio as of such dates.

(4) Return on Average Assets, Return on Average Common Equity and Dividend Payout Ratio for Common Stock based on income before cumulative effect of a change in accounting principle for 2001 would have been 2.23%, 25.93% and 16.84%, respectively.

(5) Average balances are computed on a daily basis, except for 2000, which are on a monthly basis.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Overview

Doral Financial Corporation is a financial holding company that, together with its wholly owned subsidiaries, is engaged in mortgage banking, banking (including thrift operations), institutional securities operations and insurance agency activities. Doral Financial's core business is the origination, purchase, sale and servicing of mortgage loans on single-family residences, the issuance and sale of various types of mortgage-backed securities, the holding of mortgage loans, mortgage-backed securities and other investment securities for sale or investment, the purchase and sale of servicing rights associated with such mortgage loans and the origination of construction loans and mortgage loans secured by income-producing real estate and land. As a result, the demand for mortgage loans in Puerto Rico, which is affected by such external factors as prevailing mortgage rates and the strength of the Puerto Rico housing market, has a significant influence on Doral Financial's operating results. Puerto Rico, with a population of about four million people, is an owner-driven society with home ownership at a high level of 73%, compared to 66% on the U.S. mainland. Changes in interest rates also significantly influence Doral Financial's results of operations by affecting the difference between the rates it earns on its interest-earning assets and the rates it pays on its interest-bearing liabilities, as well as impacting the gains and losses it obtains from its mortgage loan sales and investment activities.

During 2004, Doral Financial once again achieved record earnings with net income and net income per diluted share increasing by 52% and 46%, respectively. Net income for 2004 amounted to a record \$489.6 million, compared to \$321.3 million for 2003, and consolidated earnings per diluted share were \$3.95 for 2004, compared to \$2.70 for 2003. Net income for 2004 includes an income tax benefit of approximately \$77.0 million resulting from certain tax planning strategies effected by Doral Financial in response to the enactment of local legislation during the year to provide a temporary reduction in the long-term capital gain tax rates. Earnings per diluted share reflect the adoption of a new accounting pronouncement effective for periods ending after December 15, 2004, and was applied by retroactively restating previously reported earnings per diluted share. See "Changes in Accounting Standards Adopted in the 2004 Financial Statements" for a description of how this new accounting pronouncement impacts Doral Financial's earnings per diluted share. During 2004, Doral Financial obtained a return on average assets of 3.85% compared to 3.46% for 2003.

The results for 2004 reflect the continued strength of the Puerto Rico mortgage market, which has not experienced the slowdown experienced by the U.S. mortgage market since the second half of 2003. The strength of the Puerto Rico mort-

gage market permitted Doral Financial to achieve once again record mortgage loan production. Doral Financial continues to be Puerto Rico's largest residential mortgage lender.

While Doral Financial continues to diversify its sources of revenues, net gains from mortgage loan sales and fees, recorded at both its mortgage banking and banking units, continue to be its principal source of revenues. For the year ended December 31, 2004, Doral Financial's net gain on mortgage loan sales and fees was \$598.8 million compared to \$390.1 million for 2003, an increase of approximately 54%. Mortgage loan sales and fees are impacted in large part by the level of mortgage loan originations, which in turn are directly influenced by demand for housing and the level of mortgage interest rates. The volume of loans originated and purchased by Doral Financial during 2004 and 2003 was approximately \$7.8 billion and \$6.5 billion, respectively. The increase reflected the continued high demand for new housing in Puerto Rico and Doral Financial's strong share of the new housing market, especially in the growing government-sponsored affordable housing loan sector. Many of these mortgage products benefit from local tax exemption on the interest earned thereon. This market is less dependent on low mortgage rates to support origination volume prospectively, due to the incentives available to borrowers and strong housing demand, which Doral Financial expects will support its lending volume growth. Increased wholesale mortgage loan purchases also contributed to record loan production. Refinancing activity was also strong, representing approximately 55% of Doral Financial's total internally originated residential mortgage loans. This is consistent with Doral Financial's experience in Puerto Rico where refinancing activity is often motivated by the elimination of high-cost consumer debt through debt consolidation rather than a reduction in mortgage interest rates. Accordingly, refinancing activity in Puerto Rico tends to be less sensitive to changes in interest rates than it is in the mainland United States.

In addition to record loan production, Doral Financial also experienced higher gain-on-sale margins. The increased margins were driven by strong demand for mortgages from federal government-sponsored secondary mortgage entities and local financial institutions looking to increase their investments in residential mortgage loans. The higher gain-on-sale margins were also favorably impacted by a higher volume of sales of non-conforming loans, which have a higher profit margin because Doral Financial retains a portion of the interest (interest-only strips ("IOs")) in connection with the sale of such loan pools to local financial institutions. During 2004, Doral Financial retained \$509.3 million of IOs in connection with loan sales compared to \$281.3 million for 2003. See "Critical Accounting Policies – Gain on Mortgage Loan Sales" for a description of how the retention of IOs impacts Doral Financial's earnings.

Net interest income is Doral Financial's second most significant source of revenues. Net interest income is the excess of interest earned by Doral Financial on its interest-earning assets over the interest incurred on its interest-bearing liabilities. Net interest income increased by 47% during 2004 compared to 2003. The increase was driven by an increase in the Company's average interest-earning assets, which increased by 39% compared to 2003. A significant portion of this increase was recorded in Doral Financial's banking subsidiaries, which ended the year with \$9.2 billion in average interest-earning assets and contributed approximately 67% of Doral Financial's consolidated net interest income. Doral Financial anticipates that an increasing amount of its net interest income will be produced by its banking subsidiaries, which generally have access to less expensive sources of borrowings such as retail and brokered deposits and advances from the Federal Home Loan Bank of New York (FHLB). Doral Financial balances its goal to maximize net interest income with its commitment to maintaining strong asset quality. As of December 31, 2004, approximately 97% of Doral Financial's total loans consisted of loans secured by real estate.

The provision for loan losses reflected a decrease of \$8.6 million or 61% from \$14.1 million in 2003 to \$5.5 million for the year ended December 31, 2004. The lower provision for loan losses was deemed appropriate by the Company due to the fact that during 2003, Doral Financial provided a reserve for a construction loan with an outstanding balance of \$13.5 million, which was not considered a non-performing loan as of December 31, 2003, but is reflected as a non-performing loan during 2004. Also a smaller provision for 2004 resulted from a reduction in the Company's non-performing loans as well as lower net charge-offs on consumer loans.

Doral Financial also earns revenues from the sale of securities in which it invests. Doral Financial's net gain (loss) on securities held for trading, which include realized and unrealized gains or losses on its securities held for trading, including IOs, as well as on options, futures contracts and other derivatives used for interest rate risk management purposes, resulted in a loss of \$200.6 million for 2004 compared to a gain of \$5.6 million for 2003. The net loss on securities held for trading experienced during 2004 was principally due to losses on the value of Doral Financial's IOs of \$131.0 million, mainly as a result of increases in the 3-month London Interbank Offered Rate ("LIBOR") which reduced the anticipated spread on Doral Financial's variable rate IOs. The need for any further recognition of losses on the value of the IOs and the amount thereof will depend, among other things, on future increases in short-term interest rates.

Doral Financial's principal market risk is interest rate risk, the risk that the value of the Company's assets or liabilities or its income

will change due to significant changes in interest rates. Doral Financial maintains an active interest rate management program to ameliorate the potential adverse effects of a dramatic rise in long-term interest rates which includes the use of various financial instruments including derivatives. Net gain (loss) on securities held for trading also includes a loss of \$97.9 million attributable to derivatives undertaken for risk management purposes, as long-term rates failed to rise in step with short-term rates, known as the flattening of the yield curve. Doral Financial's interest rate risk management program is designed principally to protect the value of the Company's assets and income from substantial increases in long-term interest rates that cannot be absorbed in the normal course of business. During 2004, net gain on sale of securities classified as available for sale amounted to \$10.6 million, compared to \$5.4 million in 2003, an increase mostly related to an increased volume of sales.

Net servicing income for 2004 was approximately \$4.9 million compared to a loss of \$15.1 million for 2003. The increase in net servicing income was due to reduced amortization and impairment charges resulting from lower prepayments. Doral Financial recorded total amortization and impairment charges of \$35.7 million during 2004, compared to \$50.4 million for 2003, which includes \$7.1 million and \$15.9 million, respectively, of net impairment charges.

As Doral Financial has continued to develop as a diversified financial institution, its fee-based income has continued to increase. Commissions, fees and other income increased by 43% to \$36.8 million for 2004, compared to \$25.8 million for 2003. Fees earned in retail banking and insurance agency operations were largely responsible for this increase. Doral Financial continues to expand its retail branches throughout Puerto Rico and the New York City metropolitan area.

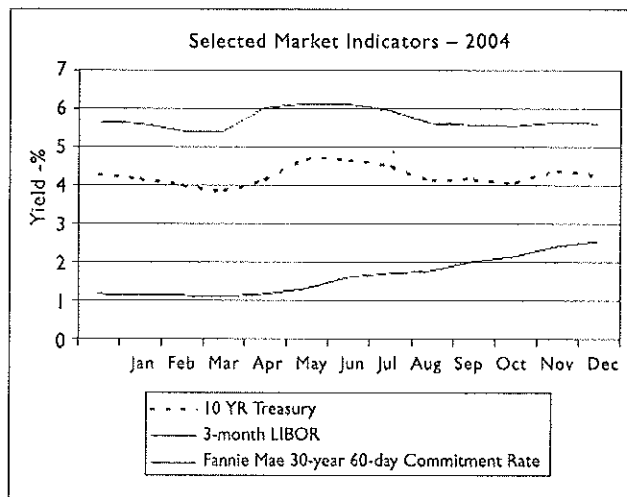
Doral Financial has adequate sources of liquidity to fund its operations. Doral Financial's historical results of operations and investment grade credit ratings allow it to access capital markets and diversify its sources of borrowings. During 2004, Doral Financial took advantage of favorable market conditions and closed the sale of an aggregate principal amount of \$740.0 million of its floating rate senior notes. The notes were sold at an average price to the public of 100.084% of the principal amount thereof, resulting in proceeds to Doral Financial of approximately \$739.3 million, after selling commissions but before expenses. The proceeds from the issuance of these unsecured debts allowed Doral Financial to match floating rate liabilities with floating rate assets and helped reduce Doral Financial's funding costs.

Doral Financial's banking subsidiaries also have the ability to raise funds quickly and efficiently through retail deposits, bro-

kered deposits and advances from the FHLB. Doral Financial's strong capital position and liquidity also permit the flexibility to invest substantial amounts in derivative instruments in order to protect the Company's revenues and assets from sudden large, unanticipated increases in interest rates.

Market Overview

The chart below shows the trends of some key selected market indicators during 2004:



Gross Domestic Product expanded at a rate in excess of 4% during the second half of 2003 and continued the solid performance during 2004 with a growth in excess of 4.4%. In response and based on available information and after three years of policy accommodation, the Federal Open Market Committee began to raise the federal funds rate at its June 2004 meeting. Between June 30 and December 10, 2004, the Fed raised the fed funds target five times in increments of 25 basis points, for a total of 125 basis points (from 1% to 2.25%).

In response to economic data and the Fed actions, the short end of the yield curve experienced increases in yields. The 3-month LIBOR increased 141 basis points from 1.15% to 2.56%. The increases in 3-month LIBOR adversely affected the spread received on the Company's variable IO portfolio and caused unrealized losses of \$131.0 million during 2004 related to these assets. After rising during the second quarter and the earlier part of the third quarter of 2004, the long end of the curve, however, experienced a moderate decrease in rates for the year. The 10-year Treasury note started the year at a yield of 4.24% and ended at 4.22%, a decrease of 2 basis points. Similarly, the Fannie Mae 30-year 60-day Commitment Rate (a proxy for mortgage rates and originations) started the year at 5.64% and ended at 5.59%, a decrease of 5 basis points. The Company's hedge program was designed to protect the Company from sharp increases across the medi-

um- and long-end curve and, given the flattening of the yield curve, did not ameliorate the unrealized losses in the value of IOs. It is unusual and atypical, all things being equal, for longer-term yields to remain stable or decrease under a rising fed funds environment.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in Doral Financial's Consolidated Financial Statements and accompanying notes. Doral Financial believes that the judgments, estimates and assumptions used in the preparation of its Consolidated Financial Statements are appropriate given the factual circumstances as of December 31, 2004. However, given the sensitivity of Doral Financial's Consolidated Financial Statements to these estimates, the use of other judgments, estimates and assumptions could result in material differences in Doral Financial's results of operations or financial condition.

Various elements of Doral Financial's accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Note 2 to Doral Financial's Consolidated Financial Statements contains a summary of the most significant accounting policies followed by Doral Financial in the preparation of its financial statements. The accounting policies that have the greatest impact on Doral Financial's statements and that require the most judgment are those relating to its mortgage loan sales and securitization activities and the ongoing valuation of the retained interests, particularly mortgage-servicing rights ("MSRs" or "servicing assets") and IOs that arise from those activities, the valuation of its derivative contracts and trading securities, and its policies regarding income accrual and the allowance for loan losses.

Gain on Mortgage Loan Sales

The Company generally securitizes or sells in bulk substantially all the residential mortgage loans it originates. FHA and VA loans are generally securitized into Government National Mortgage Association ("GNMA") mortgage-backed securities and held as trading securities. After holding these securities for a period of time, Doral Financial sells these securities for cash. Conforming conventional loans are generally sold directly to the Federal National Mortgage Association ("FNMA"), the Federal Home Loan Mortgage Corporation ("FHLMC") or institutional investors or exchanged for FNMA or FHLMC-issued mortgage-backed securities, which Doral Financial sells for cash through broker-dealers. Mortgage loans that do not conform to GNMA, FNMA or FHLMC requirements (non-conforming loans) are

generally sold in bulk as part of mortgage loan pools to local financial institutions or in negotiated transactions to government-sponsored agencies.

As part of its mortgage loan sale activities, Doral Financial generally retains the right to service the mortgage loans it sells and to retain compensation thereon. Also in connection with the sale of non-conforming mortgage loan pools and, to a lesser extent, the sale of FNMA and FHLMC securities, Doral Financial retains the right to receive any interest payments on such loans above the contractual pass-through rate payable to the investor. Doral Financial determines the gain on sale of a mortgage-backed security or loan pool by allocating the

carrying value of the underlying mortgage loans between the mortgage-backed security or mortgage loan pool sold and its retained interests, based on their relative estimated fair values. The reported gain or loss is the difference between the cash proceeds from the sale of the security or mortgage loan pool and its allocated cost after allocating a portion of the cost to the retained interests, and, in the case of loan sales with recourse provisions, the recourse obligation assumed by the Company.

Below is a hypothetical example of the operation of this accounting principle based on a sale of loans with recourse with a carrying amount of \$48.0 million:

<i>(Dollars in thousands)</i>		Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
1. Allocation of carrying amount based on relative fair values:				
Loans sold		\$ 50,000	88.3%	\$ 42,384
MSRs		750	1.3%	624
IOs		5,900	10.4%	4,992
Total		<u>\$ 56,650</u>	<u>100.0%</u>	<u>\$ 48,000</u>
2. Gain on sale calculation:				
Net proceeds from sale of loans		\$ 50,000		
Carrying amount of loans sold		(42,384)		
Recourse obligation assumed		(50)		
Gain on sale		<u>\$ 7,566</u>		
3. Doral Financial retains MSRs and IOs with a carrying amount of \$624,000 and \$5.0 million, respectively, and recognizes a recourse obligation of \$50,000. Simultaneously, the allocated carrying amount of the IOs, which are classified as securities held for trading, will be adjusted to its fair value of \$5.9 million.				

Retained Interest Valuation

Doral Financial's sale and securitization activities generally result in the recording of two types of retained interest: MSRs and IOs. MSRs represent the estimated present value of the normal servicing fees (net of related servicing costs) expected to be received on the loan over the expected term of the loan. IOs represent the estimated present value of the excess of the weighted-average fixed coupon of the loans underlying the mortgage loan pool sold over the sum of (1) the contractual interest rate required to be paid to investors and (2) a normal servicing fee after adjusting such amount for expected losses and prepayments. The contractual rate payable to investors may be either a fixed or floating rate. In the case of non-conforming loan pools, which constitute 94% of the IOs portfolio, it is generally a floating rate based on a spread over the 3-month LIBOR that resets quarterly. Generally, the loans sold are subject to interest rate caps set at or below the weighted-average coupon (less the servicing fee) on the pools of loans and to a lesser extent based on

a spread above the initial contractual pass-through rate at the time of sale, which does not exceed the weighted-average coupon on the loans. In certain instances, in lieu of a cap, Doral Financial has a call option on the pool of loans if the pass-through rate reaches a pre-determined rate below the weighted-average coupon on the loans. As of December 31, 2004, the carrying value of the IOs of \$878.7 million is related to \$7.0 billion of outstanding principal balance of mortgage loans sold to investors. As short-term interest rates increase, the spread received on the Company's retained interest decreases and adversely affects the value of the IOs. This may be offset, to some extent, by a reduction of prepayments and extension of the asset's life. Conversely, as short-term interest rates decrease, the spread received on the IOs increases, at the same time causing accelerated prepayments that shorten the life of the asset. MSRs are classified as servicing assets and IOs are classified as securities held for trading in Doral Financial's Consolidated Statements of Financial Condition.